STATE OF NORTH DAKOTA
OFFICE OF STATE TAX COMMISSIONER
RYAN RAUSCHENBERGER, COMMISSIONER

January 22, 2016

North Dakota Oil Producers and Purchasers:

RE: Oil Extraction Tax Changes Effective January 2016

Rate Update

Effective for production periods beginning January 1, 2016, North Dakota Century Code (N.D.C.C.) § 57-51.1-02 establishes an oil extraction tax rate (OET) of 5% (down from the previous rate of 6.5%).

The provisions of the newly enacted legislation include a new "price trigger" which will adjust the OET rate between 5% and 6% whenever the "average price" is above or below $90/bbl for three consecutive months. The "trigger price" of $90/bbl is subject to an annual adjustment based on changes in the producer price index for industrial commodities. The Tax Commissioner will provide the annual updated "trigger price", per the statutory guidelines, on our website at www.nd.gov/tax.

The "average price" of a barrel of crude oil, as referenced in N.D.C.C. § 57-51.1-02 is now defined as follows:

> "average price" of a barrel of crude oil means the monthly average of the daily closing price for a barrel of west Texas intermediate Cushing crude oil, as those prices appear in the *Wall Street Journal* (midwest edition). When computing the monthly average price, the most recent previous daily closing price must be considered the daily closing price for the days on which the market is closed.

Incentive Update

The OET rate reduction from 6.5% to 5%/6% was part of a comprehensive overhaul of the oil tax structure in N.D.C.C. § 57-51.1. Beginning with January 2016 production periods, OET incentives are limited to exemptions for stripper wells (S1, S2, S3 and S4), incremental oil exemptions for qualifying enhanced oil recovery units (R1), and a 2% rate on qualifying NonBakken/Three Forks new wells (RN).

Information regarding the OET incentive programs may be found in N.D.C.C. § 57-51.1-03, which can be found at http://www.legis.nd.gov/cencode/t57c51-1.pdf.

Reporting Requirements

The Tax Commissioner has reviewed the applicable statutory provisions and established the following method for administration of the statutory rate changes and elimination of incentive programs:

1. Beginning with the production period January 2016, and until such time as a "price trigger" changes the OET rate from 5% to 6%, the well code "T5" - 5% OET will be used for reporting all production and sales not qualified for a statutory tax incentive (see #3 below) or subject to first-in-first-out (FIFO) inventory accounting rules (see #5 below).

2. Production and sales from wells within the exterior boundaries of the Fort Berthold Indian Reservation must be reported on an API basis with allocations for Trust and NonTrust interests per the Tax Commissioners "Reporting Procedures Pursuant to Tribal and State Oil and Gas Agreement" letters. Well code "T5" - 5% OET will be used for reporting production and sales for Trust and NonTrust sales

not qualified for a statutory tax incentive (see #3 below) or subject to first-in-first-out (FIFO) inventory accounting rules (see #5 below).

3. Production and sales from stripper wells (S1, S2, S3, S4) and eligible NonBakken/Three Forks wells (RN) will continue to report using the well codes currently assigned.

4. Beginning with the first day of any production period following a three month period during which the "average price" exceeds the "trigger price" the "T6" - 6% OET well code will be used for reporting all production and sales not qualified for a statutory tax incentive (see #3 above) or subject to first-in-first-out (FIFO) inventory accounting rules (see #5 below).

5. FIFO Inventory accounting

   a. Crude oil is taxed at the rate in effect at the time of production. Inventory must be accounted for on a first-in-first-out basis for tax purposes. Sales of inventory barrels which were produced while a different tax rate was in effect will require multiple entries on the monthly T12 Oil Report to account for the volumes at the different tax rates.

   For example, assume API# 12304567 had 150 barrels of "PT" – 6.5% OET inventory on January 1, 2016. During the month of January 2016 there were 916.53 barrels of "T5" – 5% OET oil produced. If there were 875.35 barrels sold, the January 2016 report (due February 25, 2016) would have two entries, one with 150 barrels of "PT" – 6.5% OET inventory reported on seq#1 and one with 725.35 barrels of "T5" – 5% OET reported on seq#2 (see example below).

   If there were no sales in January 2016, or there were sales but they didn't account for all the FIFO inventory, there either would be no report on the well for January 2016 (no sales) or there would just be one entry for the "PT" – 6.5% OET inventory sold in January 2016. Any remaining FIFO inventory would be carried to the next sales month with a split reporting like shown in the example (assuming sufficient sales).

API Number (i.e. 01201234)	Sequence Number	Barrels of Oil Purchased/ Sold	Value of Oil Purchased/ Sold	Value of Exempt Government Royalties	Taxable Value of Oil	Total GPT Tax Due	GPT Previously Paid	GPT Paid By Others	GPT Paid with Report	Total OET Due	OET Previously Paid	OET Paid By Others	OET Paid with Report	Well Code	Pool Code
12304567	1	150.00	5287.50	660.94	4626.56	231.33	0.00	0.00	231.33	300.73	0.00	0.00	300.73	PT	51
12304567	2	725.35	25568.59	3196.07	22372.52	1118.63	0.00	0.00	1118.63	1118.63	0.00	0.00	1118.63	T5	51

GPT = Gross Production Tax; OET = Oil Extraction Tax

The Tax Commissioner's goal for implementation of these reporting procedures, as required by statute, is to make the process as smooth as possible. If we can provide assistance in making this happen for your company, please contact us at 701.328.2705 or by email oiltax@nd.gov.

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